

Office of Chief Counsel
Internal Revenue Service
memorandum

TL-N-4044-01
RPLaw

date: July 26, 2001

to: IRS TEGE
Attn: Corene Morton
24000 Avila Road, Room 4308
Laguna Niguel, CA 92677

from: Area Counsel (TEGE) PCCM/Los Angeles

subject: [REDACTED]
Preparation of Form 872

Disclosure Statement

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Preliminary Statement

You have advised us that in the examination of plans of the above LLC taxpayer you have noticed a potential discrepancy adjustment relating to the Form 1065 for the "members" of this LLC. In order to continue the examination you need to secure a consent to extend the statute of limitations for the initial return of the LLC, a short year beginning [REDACTED] and ending [REDACTED]. A question has arisen as to the proper form for the consent, i.e., a TEFRA partnership consent form or a regular income tax consent form.

Question Presented

Is the LLC an entity subject to the TEFRA partnership audit procedures and, if so, should the consent to extend the statute of limitations be prepared on a form 872-P/O?

Facts

The LLC was formed between [REDACTED] and

owns % of the LLC and owns % of the LLC. The first year of the LLC was, as noted above, a short year beginning and ending . On the Form 1065 filed by the LLC you have noticed a questionable deduction of \$. You question the deduction as it appears that the LLC deducted contributions paid into a multi-employer plan trust, which contributions were on behalf of collectively bargained employees for their compensation earned in periods before and after the short year ending . Thus, the contributions were not attributable to compensation earned in the tax year ending . Per the Lucky Stores/American Stores cases, such a misallocation of deductions is not allowed.

On the Form 1065 filed for the short year ending certain information is disclosed which we will note as follows:

1. Schedule B, line 1c is checked stating the entity is a Limited Liability Company.

2. Schedule B, line 4 which asks "Is this partnership subject to the consolidated audit procedures of sections 6621 through 6633?" is answered "No."

3. In the Box at the bottom of Schedule B titled "Designation of Tax Matters Partner", is listed as the TMP.

4. The K-1 attached to the form 1065 for describes this owner as a corporation.

5. The K-1 attached to the form 1065 for describes this owner as an S-corporation.

A search of IDRS concerning the status of brought up a IMFOL printout which indicates is a partnership. A search of corporate records for the State of Delaware, where it is thought is organized (due to the EIN assigned to it), proved fruitless in trying to see if is registered as a corporation or partnership in Delaware. You have determined that is a C corporation.

Applicable Law & Discussion

I.R.C. §6231(a)(1)(B) provides as follows:

(B) Exception For Small Partnerships.--

(i) In general.--The term "partnership" shall not include any partnership having 10 or fewer partners

each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner. For the purposes of the preceding sentence, a husband and wife (and their estates) shall be treated as 1 partner.

(ii) Election to have subchapter apply.--A partnership (within the meaning of subparagraph (A)) may for any taxable year elect to have clause (i) not apply. Such election shall apply for such taxable year and all subsequent taxable years unless revoked with the consent of the Secretary.

Basically, the small partnership exception (found above in the statute) is not applicable if any partner in a partnership is a "pass-thru partner" or an alien (i.e., another partnership, an S corporation, an LLC or a foreign person). See also, Temp. Treas. Reg. § 301.6231(a)(1)-1T(a)(2). The two Code sections cited above and below constitute part of the **revised** I.R.C. §6231 definitional rules and apply to partnership years ending after August 5, 1997. Taxpayer Relief Act of 1997, P.L. 105-34, §§ 1232, 1234. The year in question for this LLC ended [REDACTED].

I.R.C. §6231(g) provides as follows:

Partnership Return To Be Determinative of Whether Subchapter Applies.--

(1) Determination that subchapter applies.--If, on the basis of a partnership return for a taxable year, the Secretary reasonably determines that this subchapter applies to such partnership for such year but such determination is erroneous, then the provisions of this subchapter are hereby extended to such partnership (and its items) for such taxable year and to partners of such partnership.

(2) Determination that subchapter does not apply.--If, on the basis of a partnership return for a taxable year, the Secretary reasonably determines that this subchapter does not apply to such partnership for such year but such determination is erroneous, then the provisions of this subchapter shall not apply to such partnership (and its items) for such taxable year or to partners of such partnership.

This section means that if, on the basis of a partnership return for a taxable year, the Internal Revenue Service reasonably determines that a partnership is a TEFRA partnership

for such year, but such determination is erroneous, the TEFRA provisions shall nevertheless apply to the partnership and its partners. The reasons for the change were stated as follows:

The IRS often finds it difficult to determine whether to follow the TEFRA partnership procedures or the regular deficiency procedure. If the IRS determines that there were fewer than 10 partners in the partnership but was unaware that one of the partners was a nonresident alien or that there was a special allocation made during the year, the IRS might inadvertently apply the wrong procedures and possibility jeopardize any assessment. Permitting the IRS to rely on a partnership's return would simplify the IRS task. General Explanation of Tax Legislation Enacted in 1997, 1997-3 C.B. 481.

Since there was a significant change in the law in 1997, it is unclear how much reliance can be placed on earlier judicial precedents. Under these precedents, a court will carefully examine the Form 1065 filed for the partnership and other records to determine whether the partnership is or is not a small partnership.

The Tax Court stated in Brown v. Commissioner, T.C. Memo. 1997-548, 74 TCM 1363 (1997):

Upon our examination of the record, including the Forms 1065 for 1992 and 1993 and Schedules K-1 attached thereto, we are convinced that the Partnership was indeed a small partnership within the meaning of section 6231(a)(1)(B) in those years. In 1992 and 1993, the Partnership consisted of 10 or fewer partners based on the counting rule of section 6231(a)(1)(B)(i), which provides that a husband and wife (and their estates) shall be treated as 1 partner for purposes of that section. Moreover, we have found that each of the partners was a natural person and none was a nonresident alien during the relevant years. Sec. 6231(a)(1)(B)(i)(I).

The Tax Court stated in Harrell v. Commissioner, 91 T.C. 242 (1988):

The regulations provide that the determination of whether a partnership meets the requirements for the small partnership exception shall be made with respect to each partnership year.

Sec. 301.6231(a)(1)-1T(a)(4), Temp. Proced. & Admin. Regs. By relying on the partnership returns and accompanying K-1s to determine each partner's share of the partnership items and whether the same share rule applies, the extent to which respondent must interpret the partnership agreement each year will be minimized. We believe this approach best serves the purpose of simplicity that is behind the partnership audit and litigation provisions.

Because the Harrell case dealt with the "same share" rule under the old statute which rule was eliminated, the logic of that case, while appealing, cannot be relied on in analyzing a case that falls under the revised statute.

In the case at hand, the partnership return is not internally consistent. It appears that line 4 Schedule B of the first partnership return for this LLC was answered in the negative incorrectly, since the return did specify a "Tax Matters Partner." Only a partnership or LLC subject to the TEFRA audit procedures (or an entity who elected to be covered¹) would designate a TMP. Further, the K-1 for [REDACTED] lists it as an "S corporation" which would prevent the LLC from being governed by the small partnership exception. The Service's own computer records refer to [REDACTED] as a partnership, not an S corporation. At present, you are not 100% clear on whether [REDACTED] is a partnership or an S Corporation, but its status as either disqualifies it for the small partnership exception (or, in other words, subjects the LLC to TEFRA audit procedures). While the inconsistency troubles us, we believe the revised statute allows the Service to make a reasonable determination of the status of the partnership, even if that determination later proves wrong.

Conclusion

We suggested and you are currently securing the tax return for [REDACTED] for the period in which ends (or ends with) the LLC year ending [REDACTED]. If that return shows [REDACTED] is either a partnership or an S Corporation then we are comfortable with treating the LLC as subject to the TEFRA audit procedures. We think that your determination would be considered a reasonable one, notwithstanding the apparent incorrect answer to question 4 of Schedule B to the Form 1065 filed by the LLC. Therefore, using the form 872-P/O to extend statute of limitations is correct. Further, once you receive a copy of that return (and,

¹You have not advised us that the LLC filed an election under I.R.C. §6231(a)(1)(B)(ii), and we assume it did not.

assuming that the return is consistent with what we have advised), you should write a letter to the representative of the LLC requesting that he acknowledge that question 4 of Schedule B to the Form 1065 filed for the year ended [REDACTED] was answered incorrectly. If you are unable to secure the copy of the return for [REDACTED], then we think you must secure additional consents from the two partners of the LLC on forms 872. You should still seek an 872-P/O from the "Tax Matters Partner" [REDACTED].

Please contact us when you receive the requested return, and for certain, if the case reaches an unagreed status. If a notice of deficiency must be issued in the case, particular care will need to be taken in its preparation.

s/n

ROGER P. LAW
Attorney (TEGE)